Industry Canada Industrie Canada

Micro-Economic Monitor

Fourth Quarter 2002

Micro-Economic Analysis Directorate, Policy Sector, Industry Canada
This document is based on data up to March 18 and is also available on the Internet at
http://strategis.ic.gc.ca/sc_ecnmy/mera/engdoc/04.html

Canada

Table of Contents

Overview A

Domestic Scene

Real Economic Activity B
Income Side C
Labour Situation D
Sectoral Overview E
Productivity and Competitiveness F
International Accounts G
Price Movements H
Financial Variables I
Fiscal Track J

Annex: Budget 2003: Highlights

Overview

Real GDP growth slowed in the fourth quarter

103-05643/

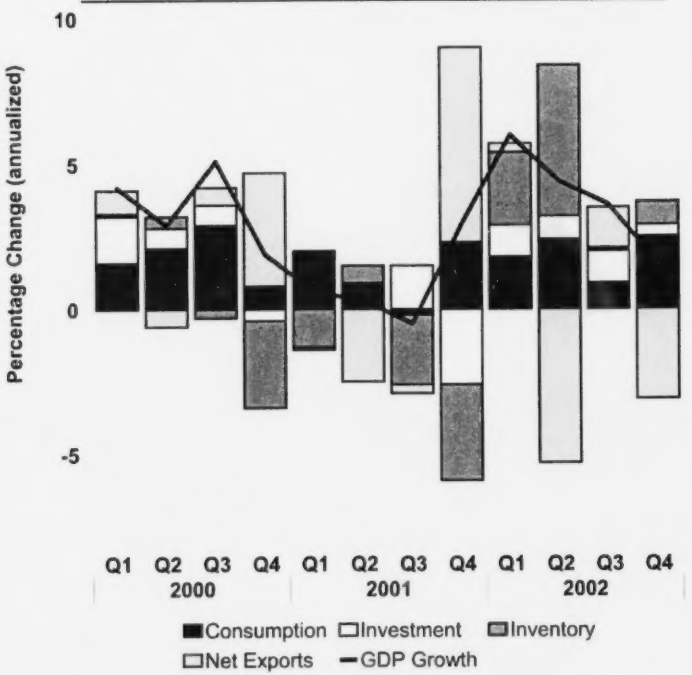
The Canadian economy continued to grow in the fourth quarter of 2002, as real Gross Domestic Product (GDP) grew by an annualized 1.6%, following an increase of 3.6% in the third quarter. The economic slowdown was concentrated in the manufacturing sector where production declined by 1.2%, after staging a sharp recovery in the first three quarters.

Strong gains in domestic demand, led by consumer spending and residential investment, were accompanied by declines in real exports and non-residential investment. Moreover, corporate profits continued to recover from their slump in 2001, while robust gains in employment led to a strong gain in real disposable income.

Recent data (exports, employment and housing starts) on balance point to continued modest growth in the first quarter.

In the United States (U.S.), real GDP increased 1.4%, down from 4.0% in the third quarter. Recent data suggest that weak economic conditions have continued in the first quarter, including significant job losses in February.

Contributions to Quarterly Real GDP Growth* (Annualized)



* For the purpose of simplification and given their relative stability over time, contributions from government expenditures are not shown.

Source: Statistics Canada

Economic uncertainty looms large, but Canada is expected to lead the G-7 in 2003

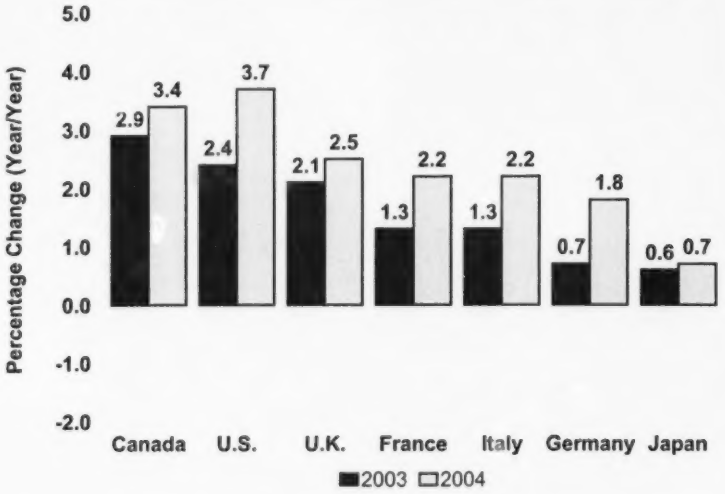
In 2002, real GDP growth in Canada was 3.4%, higher than the 2.4% growth in the U.S. Nonetheless, U.S. labour productivity in the business sector grew by 4.8% in 2002, the best annual performance since 1950. By comparison, Canada's labour productivity was up 2.2% in 2002.

While the U.S. outperformed Canada and other G-7 countries in terms of productivity growth in 2002, Canada posted the best performance among the G-7 in terms of output growth and job creation.

Short-term economic prospects remain highly vulnerable to uncertain developments in the Middle-East. Most analysts expect growth to strengthen in the second half of this year, with Canada continuing to lead the G-7 in output growth in 2003.

In line with rising core inflation and Canada's robust economic conditions and prospects, the Bank of Canada raised its overnight rate by 25 basis points to 3.0%. In the U.S., the Federal Reserve left policy interest rates unchanged.

Real GDP Growth Outlook



Source: Consensus Forecasts (U.K.), March 2003
Consensus Economics Inc.

Domestic Scene

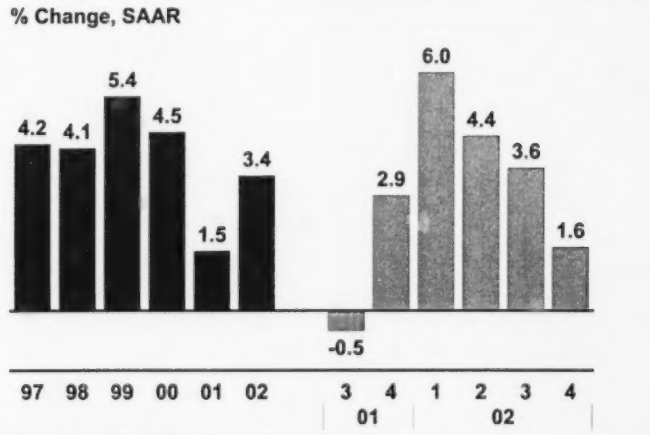
Real Economic Activity

The economy slowed in the fourth quarter...

Real GDP in the fourth quarter increased at an annualized rate of 1.6%, down from 3.6% in the third quarter.

- **Strong domestic demand, particularly for housing and related consumer goods, was accompanied by declines in exports and business investment.**

Real GDP Growth



Source: Statistics Canada

U.S. real GDP grew 1.4% in the fourth quarter, down from 4.0% growth in the third quarter, as a result of more guarded consumer spending. In 2002, the Canadian economy grew by 3.4%, up a full percentage point from 2.4% growth in the U.S.

...as Exports plunged...

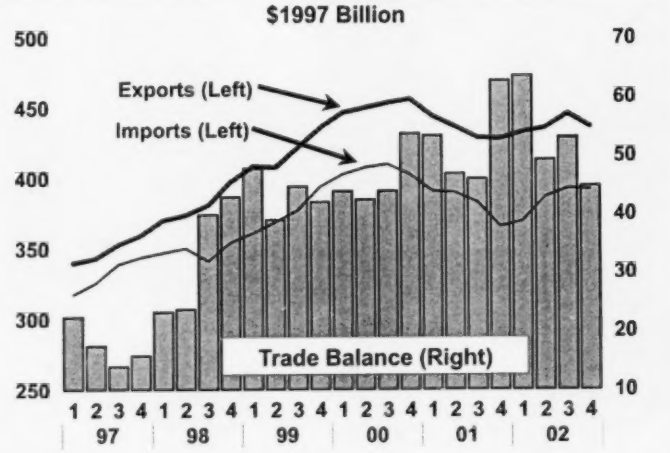
Real exports declined 8.0% in the fourth quarter, after rising 9.4% in the third quarter.

- **Weak economic activity in the U.S., particularly slower demand for motor vehicles and parts, contributed to a decline in exports.**

Imports declined 1.0%, down from 6.5% growth in the previous quarter.

- **A slowdown in demand for motor vehicle parts was also behind the decline in imports.**

Real Exports and Imports of Goods & Services



Source: Statistics Canada

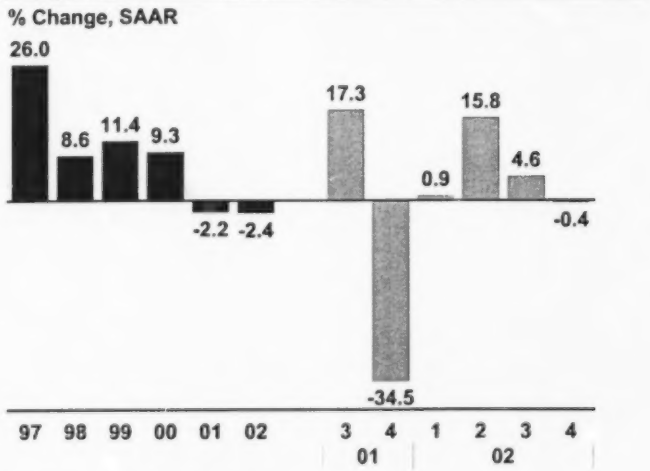
...and Investment in Machinery and Equipment stalled

Business investment in Machinery and Equipment (M&E) fell 0.4% in the fourth quarter, the first quarter of decline in 2002, after increasing 4.6% in the third quarter.

- **Lower spending on motor vehicles by businesses and a double-digit decline in telecommunications equipment investment more than offset gains in industrial machinery, computers, and software.**

- **In 2002, M&E investment fell 2.4%, following a similar decline in 2001.**

Real Machinery & Equipment Investment



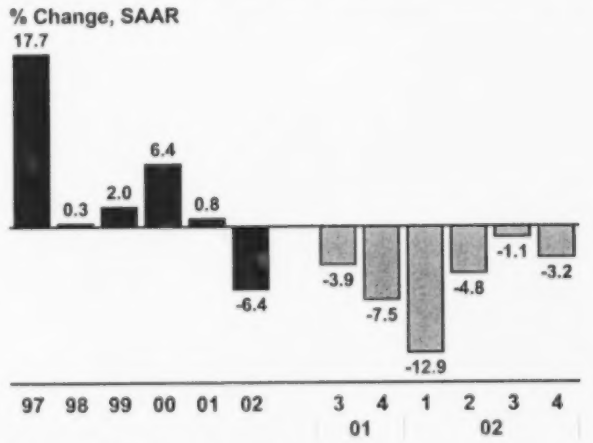
Source: Statistics Canada

Non-residential construction fell further...

Non-residential construction fell by 3.2% in the fourth quarter, the fifth quarterly decline.

Non-residential investment fell 6.4% in 2002, the first annual decline since 1991.

Real Non-residential Construction Growth



Source: Statistics Canada

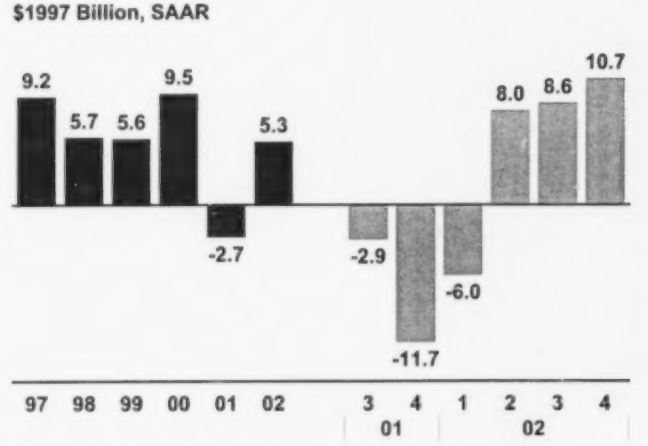
...but inventory investment increased

Non-farm inventory investment rose to $10.7 billion in the fourth quarter, up from $8.6 billion in the third quarter.

- **Inventories rose across manufacturing and trade industries, with motor vehicles accounting for most of the increase.**

The latest business conditions survey indicated the vast majority of manufacturers were satisfied with their inventory levels. The inventory-to-sale ratio remained at around 0.67.

Non-farm Business Inventory Investment



Source: Statistics Canada

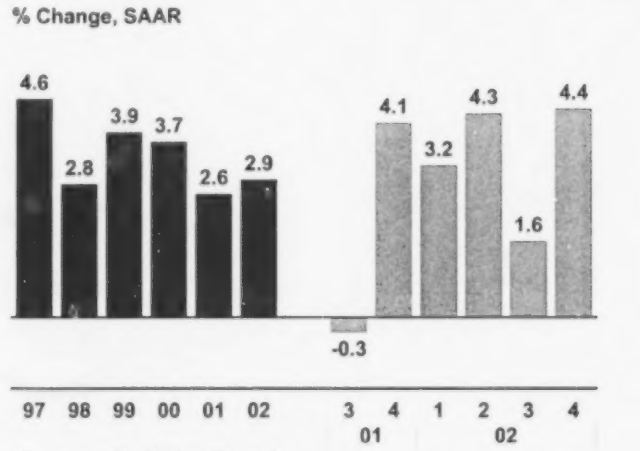
Consumer spending growth rebounded...

After a slowdown in the third quarter, consumer spending increased by 4.4% in the fourth quarter.

- **Consumer spending rose in all major goods and service categories. Spending on durables bounced back in the fourth quarter with demand for motor vehicles, household furniture, and appliances leading the advance.**

- **Expenditures on transportation services also increased, as did energy expenditures due to relatively cold weather.**

Real Consumer Expenditure Growth



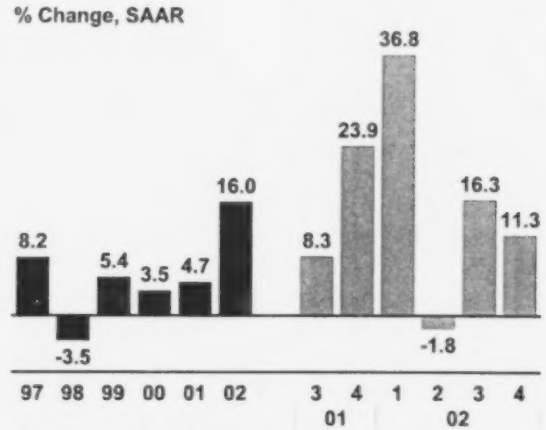
Source: Statistics Canada

...and housing activity strengthened further

Residential investment rose by 11.3% in the fourth quarter after rising 16.3% in the third quarter.

- **Housing starts climbed to their highest level since 1990.**

Real Residential Construction Growth



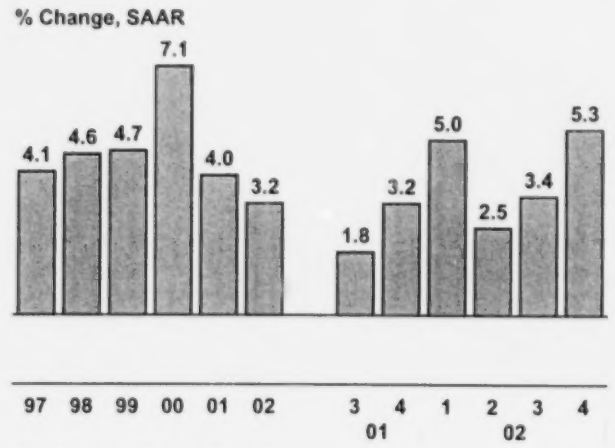
Source: Statistics Canada

Domestic Scene

Income Side

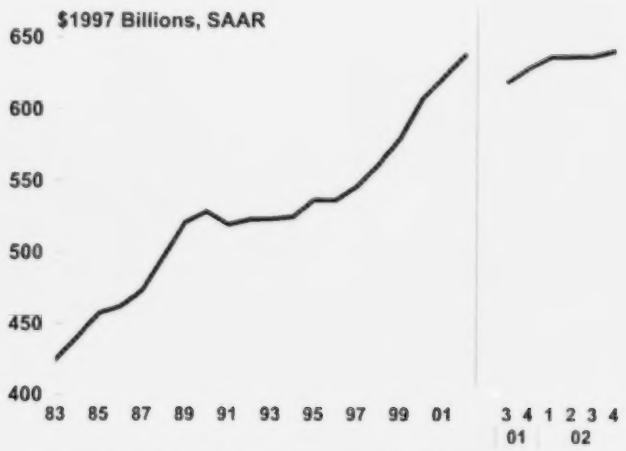
Personal disposable income growth rebounded in the fourth quarter

Growth in Personal Income



Source: Statistics Canada

Real Personal Disposable Income*



*Converted to real dollars using the chain price index for personal expenditure on goods and services.
Source: Statistics Canada and Industry Canada

Personal income rose at an annual rate of 5.3% in the fourth quarter, the strongest quarterly growth since the first quarter of 2001. The acceleration in personal income reflected stronger growth in labour income and transfers.

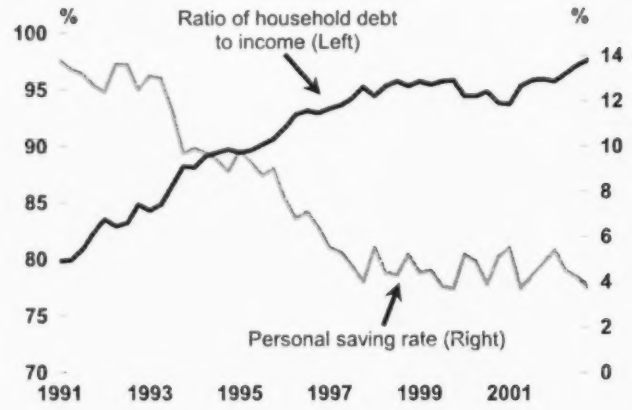
Personal disposable income rose by 4.2%, up from 3.3% in the third quarter. Real personal disposable income growth surged to 2.4% from 0.3% in the third quarter. It rose 2.5% in 2002, the sixth consecutive annual increase.

Nonetheless, consumers lowered their saving rate to support strong spending

With consumer expenditure growing faster than personal disposable income, the personal savings rate declined from 4.2% to 3.7% in the fourth quarter. The savings rate averaged 4.5% in 2002, compared to 4.6% in 2001.

The household debt-to-income ratio increased 0.5 percentage point to 97.6%, the third straight quarterly increase as the rate of consumer and mortgage debt continued to grow faster than personal disposable income.

Personal Debt and Savings Rate



Source: Statistics Canada

Corporate profits rose to a near record level

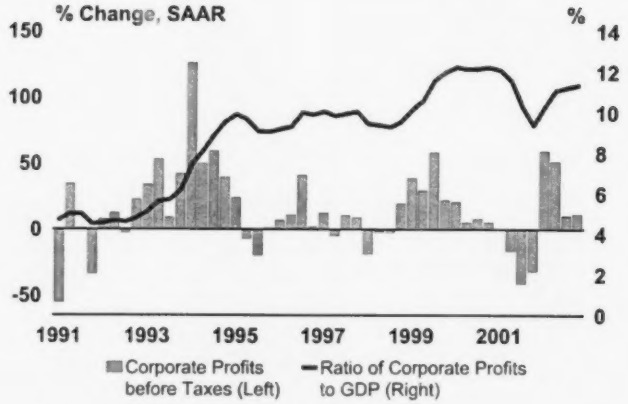
Corporate profits rose by 11.5% in the fourth quarter, following a rise of 10.4% in the third. Corporate profits posted a sharp recovery in the first half of the year and rose by 6.2% in 2002. Profits are now just 0.1% below the record level reached in the first quarter of 2001.

- **Fourth quarter gains were dominated by higher profits in the manufacturing, oil & gas, and retail sectors.**

- **For 2002 as a whole, both manufacturers and retailers reported sharp increases in operating profits compared to 2001.**

The profit share of GDP edged up slightly to 11.4% in the fourth quarter from 11.2% in the third quarter.

Corporate Profits



Source: Statistics Canada

Domestic Scene

Labour Situation

The labour market posted strong growth in February

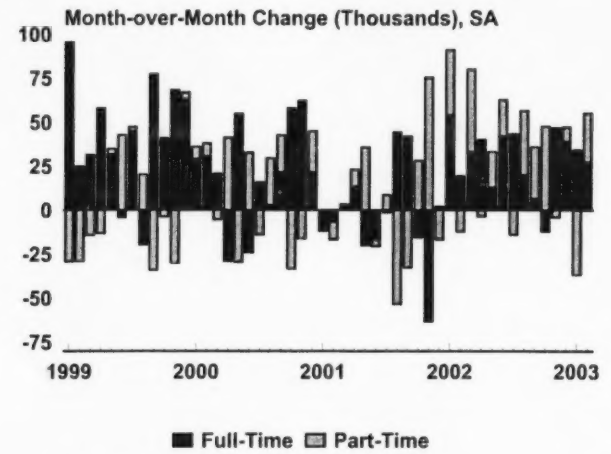
In February, employment surged by 55 000, about half were full-time jobs. So far in 2003, 53 000 jobs have been created.

- **Full-time jobs (+62 000) more than accounted for all of the gains in January and February, as part-time jobs (-9 000) decreased.**

Since the start of 2002, 613 000 (+4.1%) new jobs have been created.

- **Job creation, in the last 14 months, was split between full-time (+409 000 or 3.3%) and part-time (+204 000 or 7.4%) jobs.**

Employment Growth



Source: Statistics Canada

U.S. employment conditions remained weak in February. After increasing by 185 000 in January, non-farm employment decreased by 308 000 in February, the largest decline since October 2001. Job losses were widespread, with retail trade and services posting especially large declines. Moreover, job losses continued in the manufacturing sector (-53 000). The unemployment rate edged up 0.1 percentage point to 5.8% in February.

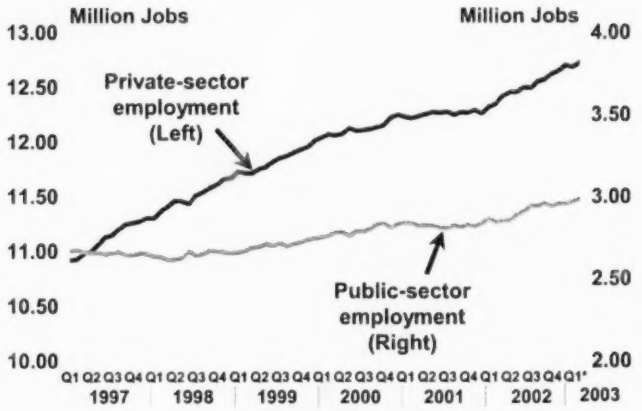
...with both private and public sectors recording increases

Led by an increase (+26 000) in paid employment, private sector employment rose by 39 000 in February. Private sector employment rose by 3.6% over last 14 months, led by gains in community services, manufacturing and business services.

The public sector created 16 000 jobs in February and since the beginning of 2002 employment in the public sector was up 5.3%. Public sector gains have been concentrated in health care & social assistance and education.

Self-employment gained 14 000 jobs in February and grew by 4.5% over the last 14 months.

Employment: Private vs. Public



*Data for 2003Q1 includes January and February only.

Source: Statistics Canada

The unemployment rate remained unchanged at 7.4%, due to a large increase in the labour force

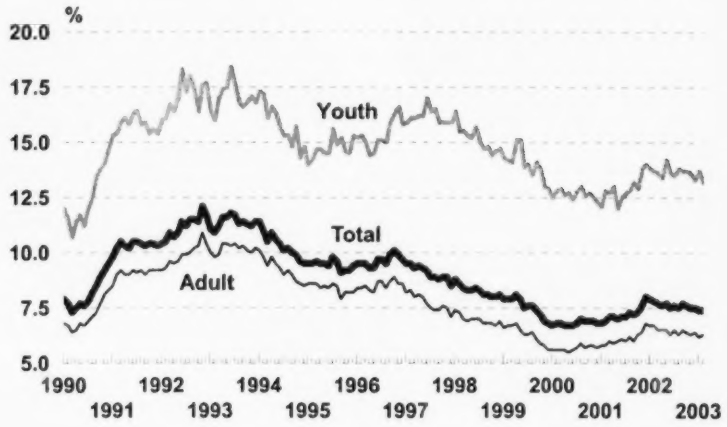
The unemployment rate remained unchanged at 7.4% in February, down only 0.6 percentage point from its peak of 8.0% in December 2001.

- **Good economic conditions have encouraged more Canadians to enter the labour force, partially offsetting the downward pressure of job creation on the unemployment rate.**

- **In February, the participation rate was at the highest level on record.**

Youth gained 30 000 jobs, more than offsetting the loss of 12 000 jobs in January. Consequently, the youth unemployment rate fell half a percentage point to 13.2%. The adult unemployment rate edged up by 0.1 percentage point to 6.3%.

Unemployment Rates



Source: Statistics Canada

All provinces, except Manitoba and Saskatchewan, posted job gains in February...

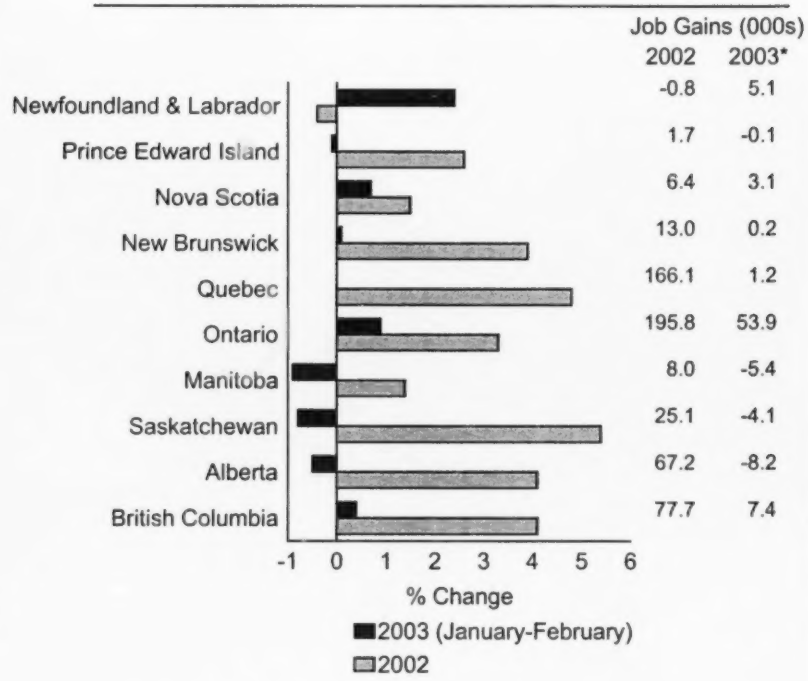
Ontario posted the largest number of job gains in February (+28 000). Services more than accounted for the overall gain, led by Professional, Scientific & Technical service jobs. The next largest increases were posted by B.C. (+12 000) and Quebec (+9 000).

All other provinces posted job gains of less than four thousand each, except Manitoba and Saskatchewan, which posted job losses of less than one thousand per province.

More than half of the job gains in Manufacturing were in Alberta and B.C.

All provinces, except Newfoundland (-1 000), posted sizeable employment growth in 2002. So far this year, job losses have been concentrated in the Prairies, while job gains have mainly been in Ontario, B.C. and Newfoundland.

Employment Growth by Province



*Figures for 2003 are year-to-date (January-February)
Source: Statistics Canada

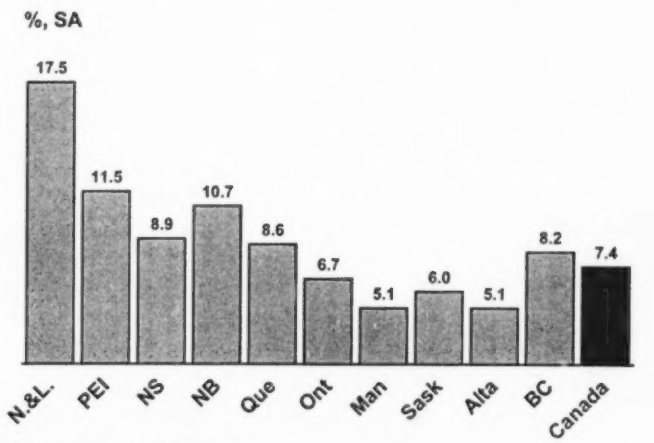
However, the unemployment rate increased in half of the provinces

February's increase in the labour force pushed up the unemployment rate in New Brunswick (+0.5 percentage point to 10.7%), P.E.I. (+0.4 to 11.5%) and Quebec (+0.2 to 8.6%).

The loss of jobs helped increase the unemployment rate in Manitoba and Saskatchewan by 0.2 percentage point in each province to 5.1% and 6.0%, respectively.

Job gains pushed the unemployment rate down in Nova Scotia (-0.5 percentage point to 8.9%), Alberta (-0.4 to 5.1%), Newfoundland (-0.4 to 17.5%) and Ontario (-0.1 to 6.7%). The unemployment rate remained at 8.2% in B.C.

Unemployment Rates: February 2003



Source: Statistics Canada

Domestic Scene

Sectoral Overview

Decline in the manufacturing sector slowed production in the Goods-producing sector...

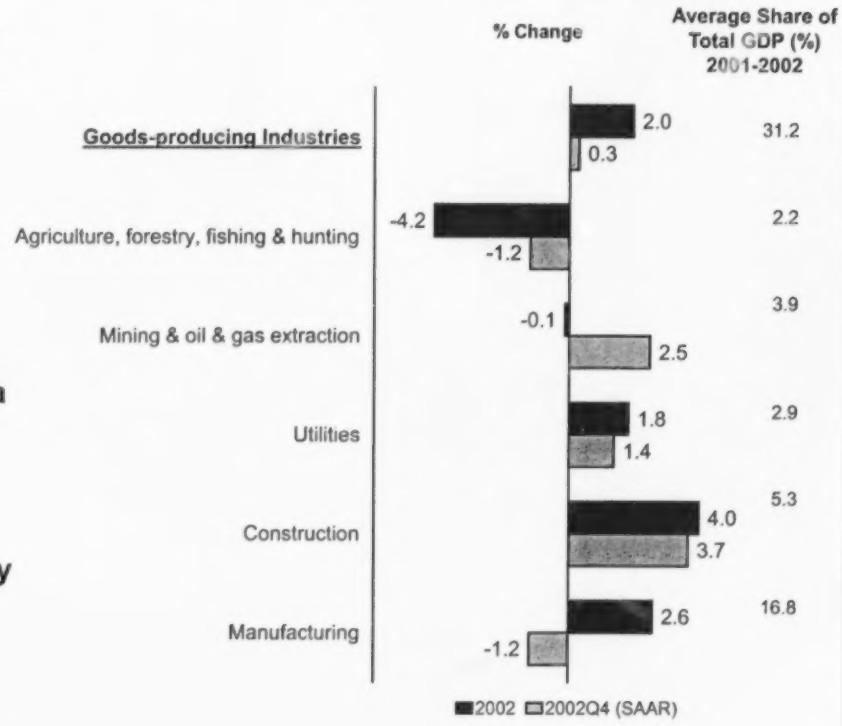
Output in the Goods-producing industries edged up by 0.3% (annual rate) in the fourth quarter of 2002, following an average quarterly increase of 5.9% in the first three quarters.

- After recording strong gains during most of the year, the Manufacturing sector declined by 1.2% in the fourth quarter. Nonetheless, Manufacturing output rose by 2.6% in 2002, following a decline of 4.6% in 2001.

- A strong housing sector continued to support solid production gains in the Construction sector, while rising energy prices led to an output increase in the oil & gas sector.

In 2002, output in the Goods-producing industries rose by 2.0%, after a decline of 2.4% in 2001. However, the level of output in the fourth quarter was only down 0.2% from its peak in the fourth quarter of 2000.

Real GDP Growth by Industry: 2002Q4



Source: Statistics Canada

...but output growth in the Service sector remained healthy

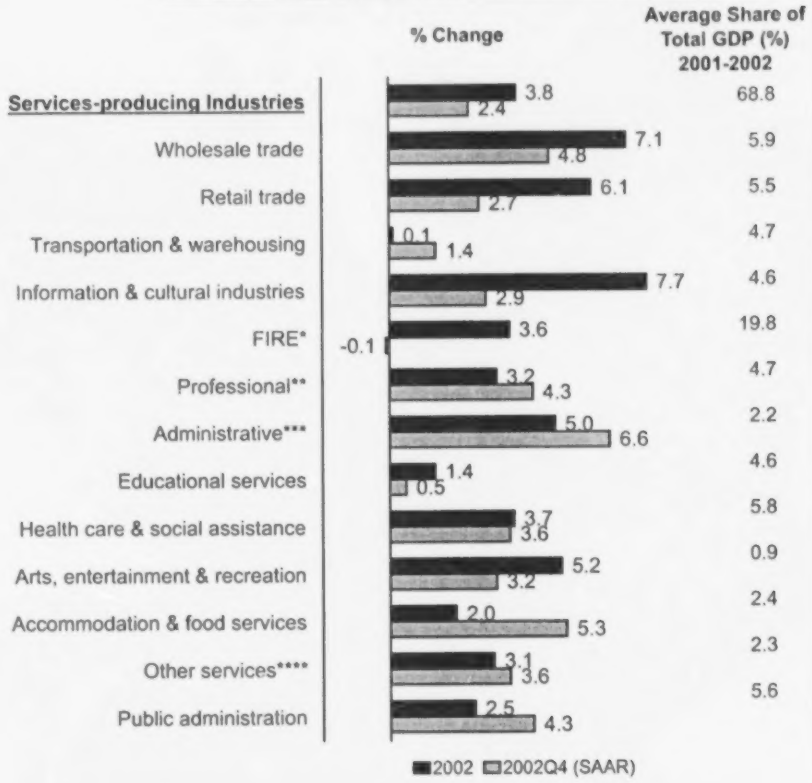
Output in the Services-producing industries was up 2.4% in the fourth quarter.

- **Led by strong output growth in the Professional, Wholesale Trade, Public Administration, Heath Care & Social Assistance, Administrative and Accommodation & Food categories, most sectors recorded gains.**

- **However, the Finance & Insurance, Real Estate & Leasing sector (FIRE), which represents 20% of total GDP, showed little growth in the fourth quarter, but rose by 3.6% in 2002.**

In 2002, output grew 3.8% in the Service-producing industries, following an increase of 3.3% in 2001 and 4.6% in 2000.

Real GDP Growth by Industry: 2002Q4



* Includes Finance & insurance, real estate & renting & leasing & management of companies & enterprises
** Includes Professional, scientific & technical services
*** Includes Administrative & support, waste management & remediation services
**** except public administration

Source: Statistics Canada

Corporate operating profits continued to rise in the fourth quarter

Corporate operating profits rose by 5.1% in the fourth quarter, continuing its recovery that began in the first quarter of 2002. Nonetheless, profits were still 7% below their peak reached in the fourth quarter of 2000. On an annual basis, profits rose by 5.8% in 2002, following a decline of 14.6% in 2001.

- **Driven by strong gains in the automotive industry throughout the year, profits in the Manufacturing sector continued to recover.**

- **Profits in the Mineral Fuels sector increased in the fourth quarter, but declined 23.2% in 2002.**

Profits in the Financial sector suffered a 6.5% profit slide in 2002, despite a slight increase recorded in the fourth quarter.

- **Lower profits in Depository Credit Intermediation (mainly chartered banks) and losses in Funds & Other Financial Vehicles were the main contributors to the decline.**

Corporate Operating Profits, 2002Q4

	2002Q4 Level ($M)	Difference 02Q3-02Q4 ($M)	02Q3-02Q4 (%)	01Q4-02Q4 (%)
Total - All Industries	**41,945**	**2,033**	**5.1**	**32.8**
Total Non-Financial	**33,960**	**1,951**	**6.1**	**38.7**
Agriculture, forestry, fishing & hunting	313	-39	-11.1	-22.5
Mineral fuels	4,349	315	7.8	54.6
Mining except mineral fuels	454	77	20.4	4.1
Utilities	673	7	1.1	8.5
Construction	1,130	234	26.1	74.9
Manufacturing industries	11,411	359	3.2	35.8
Wholesale trade industries	2,772	50	1.8	28.5
Retail trade industries	2,651	195	7.9	37.6
Transportation and warehousing	1,961	-13	-0.7	70.5
Information and cultural industries	2,072	111	5.7	60.2
Real estate, rental and leasing	3,336	432	14.9	40.1
Professional/Scientific	671	58	9.5	41.6
Management of companies	3,432	257	8.1	5.4
Other services to business	671	126	23.1	29.0
Education services	-53	-6	12.8	-19.7
Health care and social assistance	451	42	10.3	34.2
Arts, entertainment and recreation	58	-8	-12.1	-61.3
Accommodation and food services	650	-45	-6.5	12.8
Other services	389	57	17.2	43.0
Total Financial	**7,985**	**82**	**1.0**	**12.7**
Depository credit intermediation	2,852	-91	-3.1	20.9
Non-depository credit intermediation	1,331	48	3.7	-6.5
Insurers	1,177	151	14.7	24.2
Funds and other financial vehicles	-1,559	3,451	-68.9	-181.5
Other financial intermediaries	2,625	-26	-1.0	11.5

Source: Statistics Canada

Employment gains have been concentrated in the Service sector so far this year

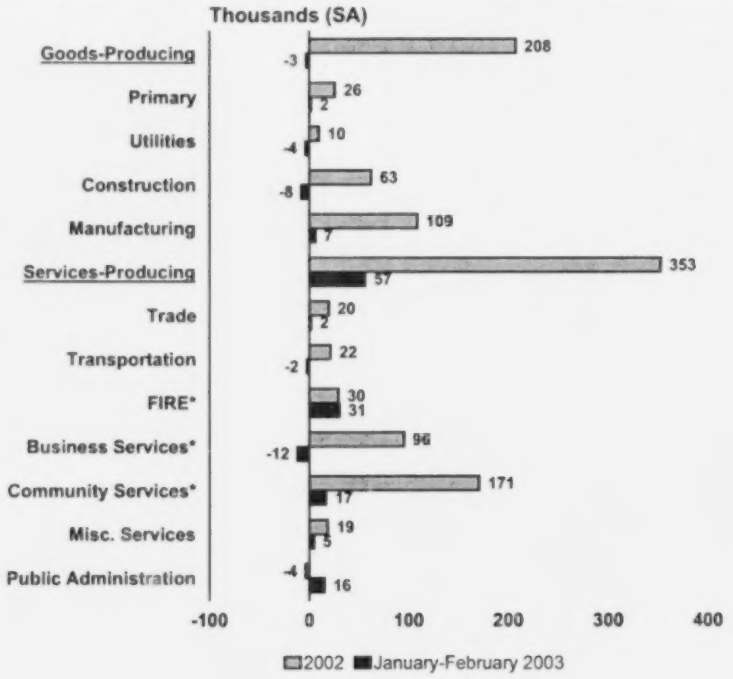
Employment in the Service sector continued its upward trend, rising by 37 000 in February and by 20 000 in January. Gains in 2003 have been concentrated in finance, insurance, real estate & leasing.

- **Since the start of 2002, 410 000 jobs have been created in the Services industries, with most sectors reporting employment gains. Community services has been an area of strength with health & social assistance and educational services recording solid gains.**

Employment in the Goods sector posted a gain of 19 000 jobs in February, after the loss of 22 000 jobs in January. In February, manufacturing (+21 000) more than regained the job losses in the previous month.

- **In the Goods sector, employment has been up 205 000 since the start of 2002. Manufacturing created 116 000 jobs and construction 55 000.**

Job Growth by Industry

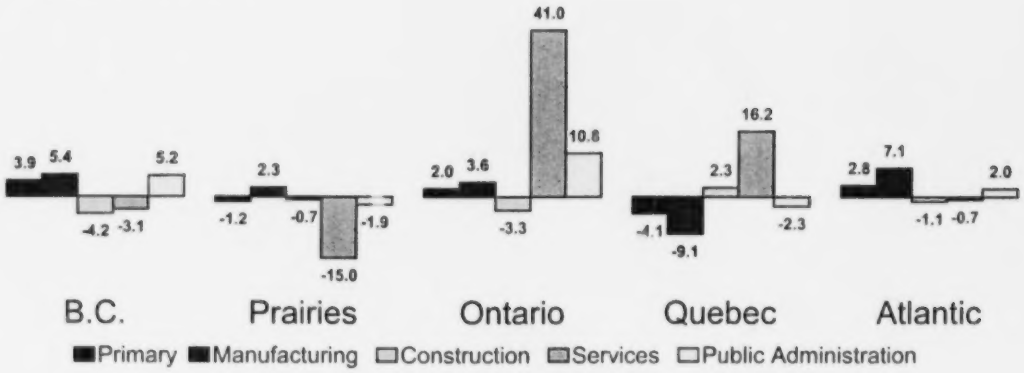


*FIRE: Finance, Insurance, Real Estate and Leasing
Business Services: Management, Administrative, Professional, Scientific & Technical Services
Community Services: Educational Services, Health & Social Assistance.

Source: Statistics Canada

In 2003, gains have been concentrated in Ontario and Quebec

Job Creation
Thousands
Seasonally adjusted
January - February 2003
Source: Statistics Canada



On a year-to-date basis, manufacturing employment increased in all regions, except in Quebec (-9 000). Atlantic Canada and B.C. accounted for most of the jobs created in manufacturing. Primary sector employment in Quebec and the Prairies was driven down by losses in agriculture. Construction employment fell in all regions, except Quebec.

Employment gains in Services were solely due to gains in Ontario and Quebec. Meanwhile, employment in public administration posted gains in all regions, except for small losses in Quebec & the Prairies.

Wage settlements moderated, but real wage grew in 2002

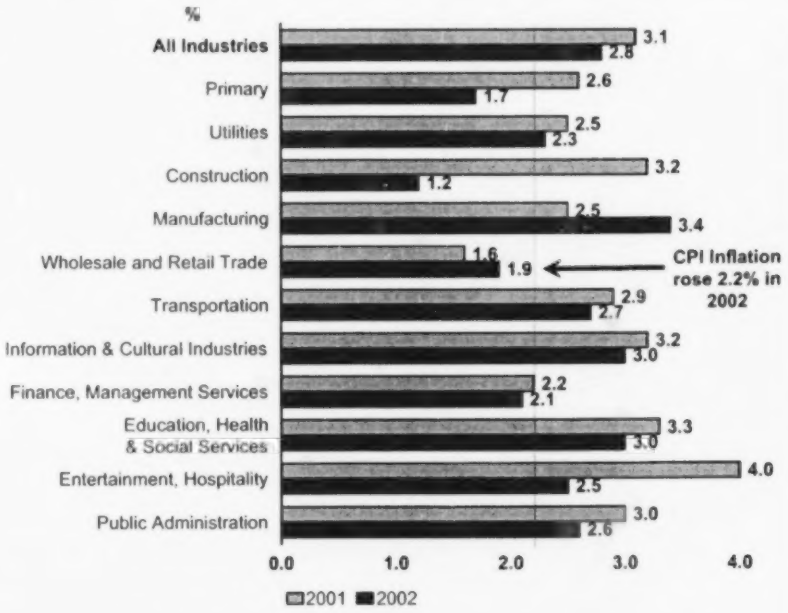
Wage settlements averaged 2.8% in 2002, slightly below the pace set in 2001. However, with Consumer Price Index (CPI) inflation averaging only 2.2%, in real terms wages grew by 0.6%.

- **Settlements in seven of eleven industry groups outpaced the CPI inflation.**

- **Driven by strong employment demand, the manufacturing sector posted the highest growth in wage settlements in 2002.**

For the third consecutive year, Public-sector wage settlements (+2.9%) were above those in the Private sector (+2.6%).

Wage Settlements by Industry



Effective average annual adjustments in base wage rates from major collective bargaining agreements.

Source: Human Resources Development Canada

Capacity use fell slightly in the fourth quarter

Capacity utilization edged down 0.2 percentage point to 82.9% in the fourth quarter of 2002, the first decline since the fourth quarter of 2001.

- **Driven by a strong residential construction sector, the capacity use in the Construction industry continued to increase. Lower production pushed down capacity use in the Oil & Gas Extraction sector to its lowest level on record.**

- **Within Manufacturing, capacity utilization decreased in 13 of 21 industry groups. Capacity use in Transportation Equipment declined as strong domestic demand for motor vehicles more than offset lower exports. On the other hand, a vigorous residential sector pushed up the capacity use in the Wood Products sector to its highest level on record.**

For 2002 overall, capacity utilization edged up 0.2 percentage point to 82.5%.

Capacity Utilization: Non-farm Goods-producing Industries

	Level (%) 2002	Change 2002/2001	Level (%) 2002Q4	Change 02Q4/02Q3	10-year Average
Total Industrial	**82.5**	**0.3**	**82.9**	**-0.2**	**82.5**
Forestry & logging	77.4	0.6	80.3	-1.4	80.5
Mining & oil & gas extraction	71.9	-4.7	71.4	-0.3	78.5
Electric power *	88.5	1.0	88.3	-1.2	84.0
Construction	86.0	-0.3	86.1	0.1	82.2
Total Manufacturing	**83.5**	**1.6**	**84.3**	**0.0**	**83.5**
Food	81.6	0.0	80.8	-0.5	80.7
Beverage & tobacco products	79.8	-0.8	77.3	-3.5	80.9
Textile mills	76.6	-2.3	75.0	-1.5	82.0**
Textile product mills	79.3	2.7	79.2	-2.6	79.4**
Clothing	81.9	-0.1	85.2	2.5	82.7
Leather & allied products	70.4	-2.1	69.0	-1.5	74.3
Wood products	93.8	11.8	98.5	3.4	87.0
Paper	90.4	1.8	93.0	0.3	90.2
Printing & related support activities	72.9	-3.6	69.9	-2.4	77.8
Petroleum and coal products	96.3	1.4	96.0	-0.6	92.4
Chemical	81.1	0.7	84.1	2.8	82.4
Plastic & rubber products	88.7	4.5	88.9	-0.5	84.2
Non-metallic mineral products	83.9	4.0	85.5	1.8	78.5
Primary metal	91.2	2.6	93.7	1.9	90.4
Fabricated metal products	83.7	3.0	83.9	-0.7	80.5
Machinery	80.0	0.7	83.0	2.2	80.9
Computer & electronic products	66.8	-5.4	64.7	-1.1	80.0
Electrical equipment	73.1	-3.2	72.4	-0.8	83.4
Transportation equipment	88.9	3.0	88.9	-2.4	85.6
Furniture & related products	82.2	1.4	82.0	-1.1	81.3
Miscellaneous manufacturing	82.5	2.2	84.5	1.4	82.1

* Electric power generation, transmission & distribution
** Represents available data between 1997Q1-2002Q4
Source: Statistics Canada

Domestic Scene

Productivity & Competitiveness

Labour productivity fell in the fourth quarter...

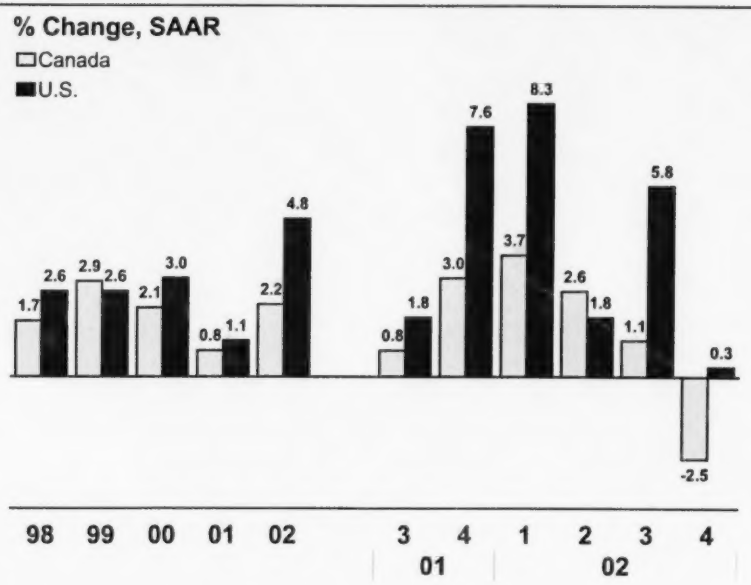
Business sector labour productivity declined 2.5% (annual rate) in the fourth quarter, reflecting much stronger growth in hours worked (3.6%) than output (1.0%).

However, for 2002 as a whole, productivity increased 2.2%, more than twice the growth rate in 2001 and the best performance since 1999.

Labour productivity in the U.S. business sector increased 0.3% in the fourth quarter as output grew (1.8%) faster than hours worked (1.5%). In 2002, productivity rose 4.8%, the largest increase since 1950.

In 2002, U.S. labour productivity growth continued to be higher than that of Canada, while Canada posted stronger growth in output (3.8% versus 2.7%) and hours worked (1.5% versus -2.0%).

Productivity Growth



Source: Industry Canada calculations

F-1

...driving unit labour costs up

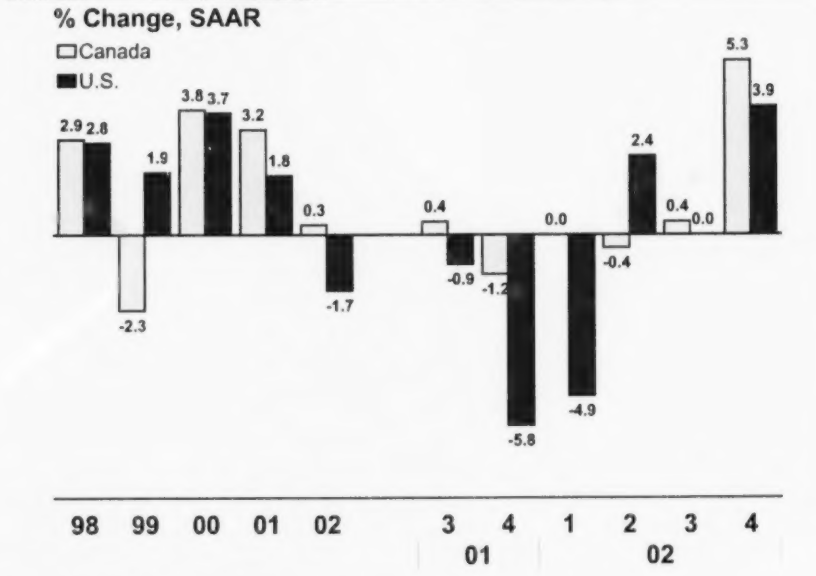
Unit labour costs rose 5.3% in the fourth quarter, as hourly wages increased (2.8%) and labour productivity fell.

However, for 2002 as a whole, unit labour cost edged up by only 0.3%, down sharply from 3.2% in 2001 and 3.8% in 2000.

- **In 2002, hourly wages increased 2.6% while labour productivity rose 2.2%.**

U.S. unit labour costs increased 3.9% in the fourth quarter, as wages rose 4.2%. Unit labour costs, however, declined 1.7% in 2002, the first annual drop since the early 1960s, as productivity grew faster than wages.

Growth in Unit Labour Costs*



* For the business sector

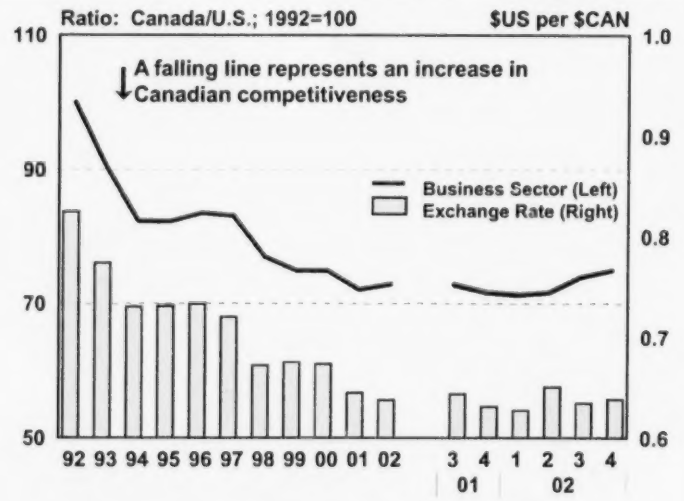
Source: Statistics Canada, Bureau of Labor Statistics and Industry Canada calculations.

...and eroding Canadian firms competitiveness

In the fourth quarter, Canadian businesses competitiveness relative to their American counterparts deteriorated further as the Canadian dollar edged up and labour productivity declined in Canada.

Although the American currency appreciated slightly, in 2002, firms south of the border improved their competitiveness. This was largely the result of a stronger labour productivity performance in the U.S. as growth in hourly compensation was similar on both sides of the border.

Unit Labour Cost Comparison ($US)



Source: Industry Canada calculations based on data from the U.S. Bureau of Labor Statistics and Statistics Canada

Domestic Scene

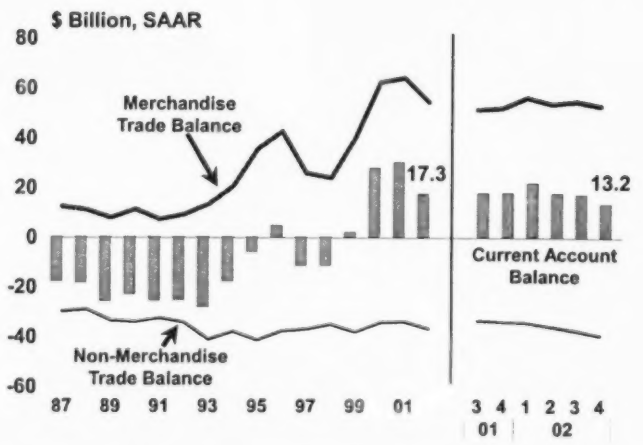
International Accounts

The current account surplus decreased in the fourth quarter...

Canada's current account surplus decreased by $0.9 billion to $3.3 billion ($13.2 billion annualized) in the fourth quarter, mostly attributable to a deterioration in investment income and merchandise trade.

In 2002, the surplus in the current account fell to $17.3 billion, from the record $30.0 billion in 2001. The goods surplus fell $9.8 billion on lower exports and higher imports. Dividends received by Canadian direct investors on their foreign investments were lower, by $2.3 billion, compared to 2001.

Current Account & Trade Balances



The merchandise trade balance represents net exports of goods.

The non-merchandise trade balance represents net exports of services plus net receipts of investment income and transfers.

Source: Statistics Canada

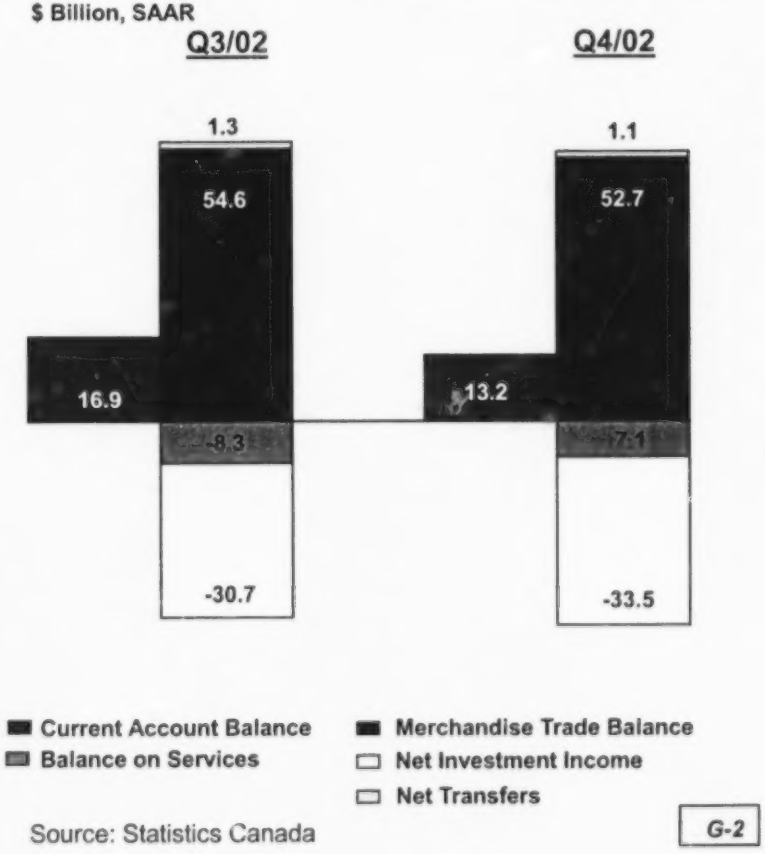
...largely reflecting a deterioration in investment income and merchandise trade balances

The deficit on investment income rose by $0.7 billion to $8.4 billion, as the payment of dividends to foreign direct investors increased by $0.6 billion.

The merchandise trade surplus decreased by $0.5 billion to $13.2 billion ($52.7 billion annualized) in the fourth quarter, as exports fell due to a large drop in exports of automotive products.

The deficit on services dropped from $2.1 billion in the third quarter to $1.8 billion ($7.1 billion annualized) in the fourth quarter. The reduction was spread evenly between travel, transportation and commercial services.

Main Components of the Current Account



Source: Statistics Canada

G-2

A decline in real merchandise exports was moderated by an increase in export prices...

Real merchandise exports decreased in the fourth quarter by 2.3%, but an increase in export prices moderated the decrease in nominal exports to 0.2%. This follows a gain of 2.7% in the third quarter.

- **Lower shipments of passenger cars led to a large drop in exports of automotive products. This was partially offset by higher exports of energy, due to a combination of higher prices and volumes.**

Total exports fell 1.0% in 2002. Energy exports faced a notable decline (-7.9%), as did Forestry products (-6.8%) and Machinery and Equipment (-5.0%). Buoyant U.S. consumer spending led to an increase in exports of consumer goods and automotive products.

The geographic decline was widespread, except the 2.4% increase in exports to Japan.

Merchandise Exports, 2002

	$ Billion	% Change Jan.-Dec./01 - Jan.-Dec./02
Total	410.7	-1.0
By Trade Partner		
U.S.	348.4	-0.7
Japan	9.7	2.4
E.U.	21.2	-4.9
All Others	31.4	-1.8
By Principal Commodity		
Agricultural & Fishing Products	30.5	-1.1
Energy Products	50.4	-7.9
Forestry Products	36.7	-6.8
Industrial Goods & Materials	69.4	3.9
Machinery & Equipment	94.7	-5.0
Automotive Products	97.1	4.5
Other Consumer Goods	17.3	8.6

Source: Statistics Canada

...while imports remained stable

Merchandise imports were unchanged in the fourth quarter, following an increase of 2.8% in the third quarter.

- **Lower imports of automotive parts more than offset the higher imports of cars and trucks. Imports of energy products rose.**

Total imports in 2002 rose by 1.6%. Notable increases were recorded for imports of automotive products, forestry products, other consumer goods, and agricultural & fishing products, offsetting declines in imports of energy products and M&E.

- **Imports from the U.S. edged down, while they rose from other regions, particularly Japan.**

Merchandise Imports, 2002

	$ Billion	% Change Jan.-Dec./01 - Jan.-Dec./02
Total	356.1	1.6
By Trade Partner		
U.S.	254.7	-0.1
Japan	11.7	10.9
E.U.	36.1	3.0
All Others	53.5	7.2
By Principal Commodity		
Agricultural & Fishing Products	21.8	7.0
Energy Products	16.5	-7.3
Forestry Products	3.1	8.6
Industrial Goods & Materials	68.8	0.5
Machinery & Equipment	105.8	-5.9
Automotive Products	81.4	12.3
Other Consumer Goods	46.4	8.1

Source: Statistics Canada

The foreign portfolio investment into Canada bounced back in the fourth quarter

In the fourth quarter, Canadians invested $24.1 billion abroad, while foreigners invested $16.1 billion in Canada. In 2002, Canadians continued to invest more abroad ($75.6 billion) than foreigners invested in Canada ($64.1 billion).

Direct Investment

At $16.0 billion, Canadian direct investment abroad was $3.5 billion higher than in the third quarter. Nearly all of this investment went to existing affiliates for working capital. Foreign direct investment of $5.7 billion flowed into Canada, following an inflow of $1.7 billion in the third quarter. Foreign acquisitions accounted for about one-third of the total.

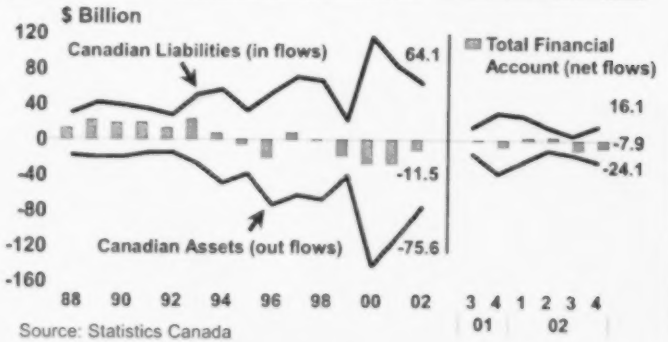
In 2002, foreign direct investment totalled $33.6 billion, while Canadians invested $43.9 billion abroad. Both Canadian and foreign investment was down compared to 2001.

Portfolio Investment

Foreign portfolio investors bounced back, investing $9.4 billion in Canadian securities, as Canadian investment in foreign securities fell to $2.8 billion.

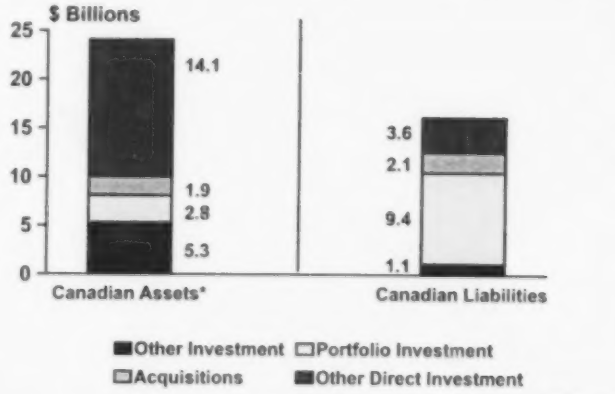
In 2002, portfolio investment was down.

Financial Account (Net Flows)



Source: Statistics Canada

Financial Account Components, Q4/2002



* Reverse of BOP sign
Source: Statistics Canada

Domestic Scene

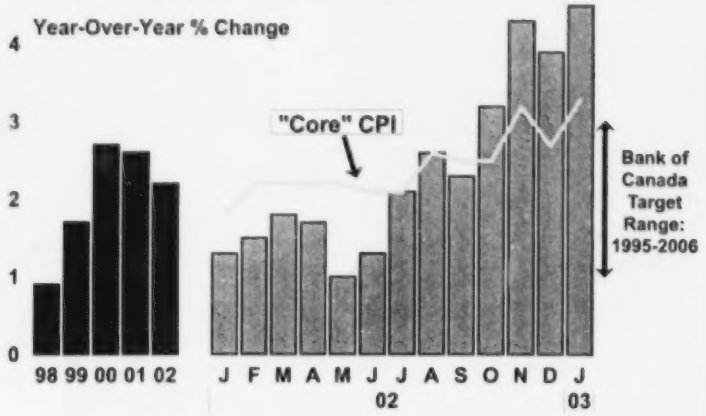
Price Movements

Inflation rose in January...

The year-over-year change in the CPI was 4.5% in January, up from 4.3% in November and 3.9% in December when the Ontario electricity rebate helped moderate inflation.

"Core" inflation – which excludes the most volatile components of the overall CPI and indirect taxes, and is the target for monetary policy – rebounded to 3.3%, from 3.1% in November and 2.7% in December. This was above the upper bound of the official 1-3% target range.

Consumer Price Index



In May 2001, Bank of Canada and the Finance Department announced the renewal of the inflation target for monetary policy until 2006. The Bank also refined its measure for the underlying trend in inflation as measured by "core" inflation.

The "Core" CPI excludes prices for: fruit, fruit preparations and nuts; vegetables and vegetable preparations; gasoline; fuel oil; natural gas; mortgage interest; inter-city transportation; and tobacco products. It also excludes the effect of changes in indirect taxes.

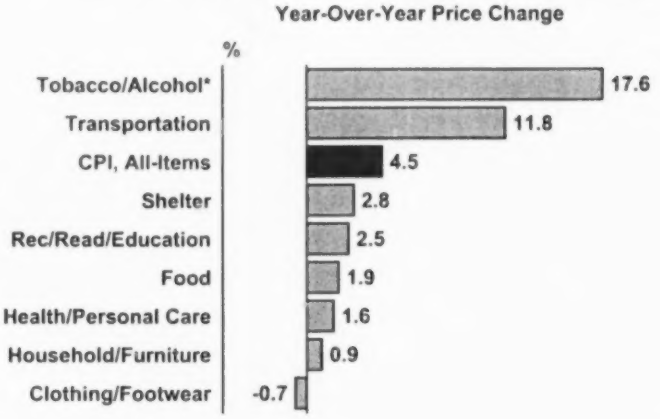
Source: Statistics Canada & Bank of Canada

...as worries of war and disruptions in oil supply pushed energy prices up

In January, the energy index was up 15.3%, compared to 7.1% in December, reflecting rises in all four major components.
CPI inflation, excluding the effect of energy, has stood at 3.5% for three straight months.

An acceleration in public transportation costs also boosted inflation.

Components of CPI: January 2003



* Increases in provincial and federal sales taxes on cigarettes, the most recent in the summer of 2002, have pushed the Tobacco & Alcohol price index higher. As a result, the year-over-year rise in the index has averaged 16.9% since November 2001, when the series of tax increases began.

Source: Statistics Canada

Prices for raw materials and manufactured products rise further

Industrial product prices – those received by producers at the factory gate – posted a year-over-year increase of 2.0% in January, after an increase of 2.7% in December.

- **Excluding petroleum and coal products prices, producer prices edged up 0.2% after rising by 1.5% in December.**

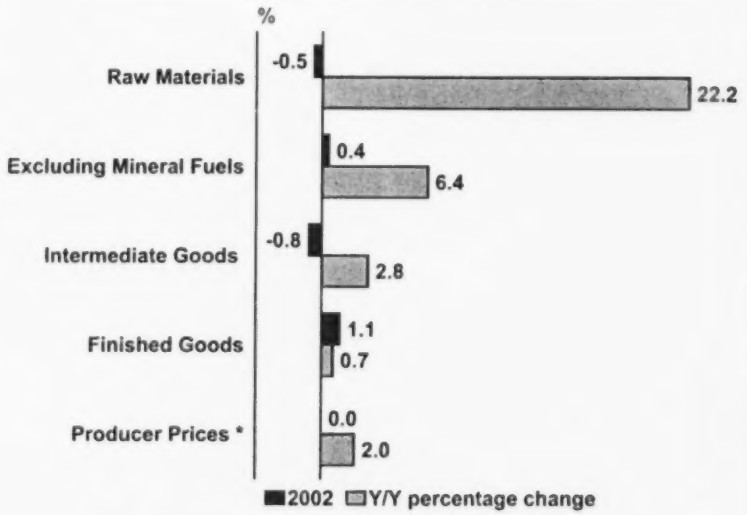
- **For the year 2002, producer prices were on average the same as in 2001. This contrasted with 2000 when prices rose 4.3%.**

Raw material prices soared 22.2% on a year-over-year basis, following a strong rise of 18.6% in December.

- **Excluding mineral fuels, prices were up 6.4%, less than the 7.8% rise in December.**

- **In 2002, raw material prices fell by 0.5%, the second annual decline after rising by 22.3% in 2000.**

Price Chain - January 2003



* Producer prices and the exchange rate effect: The appreciation of the Canadian dollar on Canadian exports quoted in U.S. dollars - particularly, motor vehicles, pulp, paper and wood products - dampened the 12-month change in producer prices in January. Excluding the effect of the exchange rate, the IPPI would have increased by 2.9% instead of 2.0%.

Source: Statistics Canada

Domestic Scene

Financial Variables

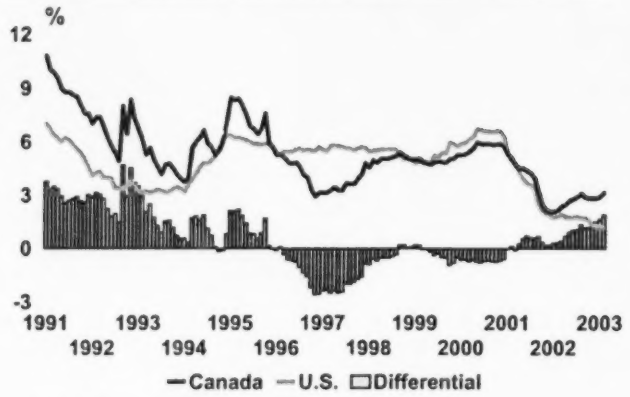
The Bank of Canada raised interest rates for the first time since July 2002

On March 4th, the Bank of Canada, faced with slowing economic growth but persistent high inflation, increased its target for the overnight rate by 25 basis points to 3.0%. With growth expected to accelerate in the second half of this year, the Bank is widely expected to raise interest rates further in the coming months.

In the United States, the Federal Reserve left its Federal Funds rate unchanged at 1.25% on March 18. The Fed took a wait-and-see approach in light of the unusually large uncertainties clouding the geopolitical situation in the short-term and their apparent adverse economic impacts.

The spread between the Canadian 90-day corporate paper rate and its U.S. counterpart was 204 basis points (bps) on March 13th, up from 153 bps at the beginning of 2003.

Short-Term Interest Rates



Last data point plotted: March 5, 2003

Source: Bank of Canada, 90-day prime corporate paper, last Wednesday in the month

2003 interest rate setting dates

Canada	United States
March 4	March 18
April 15	May 6
June 3	June 24-25
July 15	August 12
September 3	September 16
October 15	October 28
December 2	December 9

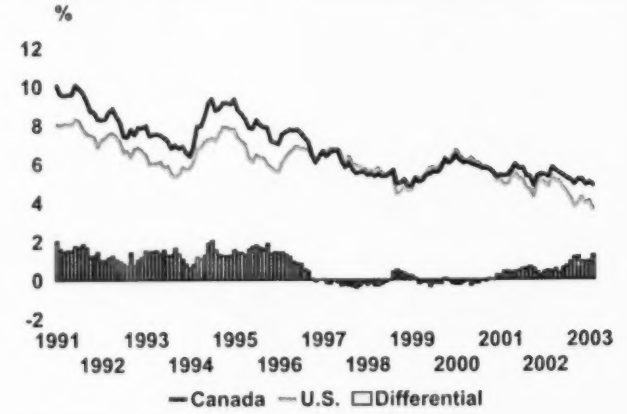
North American long-term interest rates trended downward

Bond markets have been volatile amid mixed economic developments and geopolitical uncertainties.

- **On March 13th, the 10-year Canadian bond yield was 4.9%, back to where it stood at the beginning of the year, while its U.S. counterpart was down to 3.7%, from 4.1% at the start of the year.**

- **This brought the Canada-U.S. bond yield spread to 120 basis points (bps), up from 85 bps at the beginning of this year.**

Long-Term Interest Rates



Last data point plotted: March 5, 2003

Source: Bank of Canada, 10-year Government bond, last Wednesday in the month

Wary investors sold equities amid heightened geopolitical uncertainty

Stock markets have trended down in recent months as the fear of a war further delaying business investments and the economic recovery has completely overshadowed the announcements of productivity-driven profits by leading corporations.

- **The S&P/TSX index hit a low of 6229 in early March, down 9% from the high reached at the beginning of this year, and closed out at 6304 on March 14th. The Dow Jones hit a low of 7524, but bounced back by 4.5% to 7860 on the 14th.**

Stock Market Indices

Last data point plotted: March 6, 2003

* On May 1st, Canada's main equity index was renamed the Standard & Poor/Toronto Stock Exchange index (S&P/TSX).

Source: Statistics Canada

The Canadian dollar soared to a multi-year high

The Canadian dollar, which ended 2002 at US63.4¢, surged to over the US68¢ mark in early March, the highest since 2000.

- **This recovery was prompted by the weakening of the U.S. currency, more favourable economic conditions, higher interest rates in Canada, and rising commodity prices.**

Canada-U.S. Exchange Rate

Last data point plotted: March 5, 2003

Source: Bank of Canada

Domestic Scene

Fiscal Track

The federal government tabled a new budget

On February 18th, the Government presented a balanced budget for this year and the next two fiscal years. Further details can be found in the Annex.

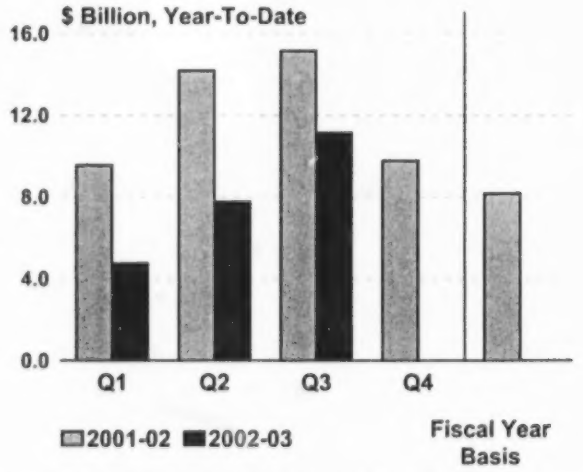
For the 2001-02 fiscal year, the federal government posted a budgetary surplus of $8.1 billion, revised from $8.9 billion to reflect the impact of full accrual accounting*. This surplus helped reduce the net debt-to-GDP ratio to 46.5%, down from a peak of 67.5% in 1995-96.

Over the first ten months of fiscal year 2002-03, the federal government posted a surplus of $11.2 billion, compared to a surplus of $15.3 billion reported for the same period last year.

- **The lower surplus reflects smaller budgetary revenues and higher program spending. Smaller budgetary revenues can be attributed to lower final tax payments and higher refunds with respect to the 2001 tax year, reflecting weakness in the stock market and the associated lower net capital gains realizations.**

Provinces, except B.C., P.E.I. and Nfld & Lab., are expected to record balanced budgets or surpluses in 2002-03, while the three territories should post deficits.

Federal Budgetary Balance



Source: Department of Finance Canada

***Under full accrual accounting, expenditures/revenues are registered on the basis of their use/economic impact in the year they occur (not on the basis of cash paid/revenue collected).**
The Government has been moving in that direction since 1999.
For more details, consult Annex 6 of the Budget Plan 2003 at http://www.fin.gc.ca/budtoce/2003/budliste.htm#plan.

For Further Information

We welcome your questions, comments and suggestions? You can reach us by ...

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phoning:	**(613) 995-8452**
or faxing us at:	**(613) 952-1936**

The *Micro-Economic Monitor* is prepared on a quarterly basis by the Micro-Economic Analysis Directorate of Industry Canada. The Monitor provides a quick and easy-to-read update on Canada's economic performance. It also provides topical in-depth reports on current economic issues from a micro-economic perspective. This report uses data available as of March 18, 2003.

The current analysis update was prepared by Eric Chalifoux, Stéphane Crépeau, Anik Dufour, Kevin Koch, Joseph Macaluso, Arif Mahmud, Sue Moore, François Poitras, François Rimbaud, and Patrick Taylor under the direction of Hossein Rostami. Translation has been provided by Lucie Larocque and Sue Hopf is responsible for administrative support.

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Industry Canada Industrie Canada

Budget 2003

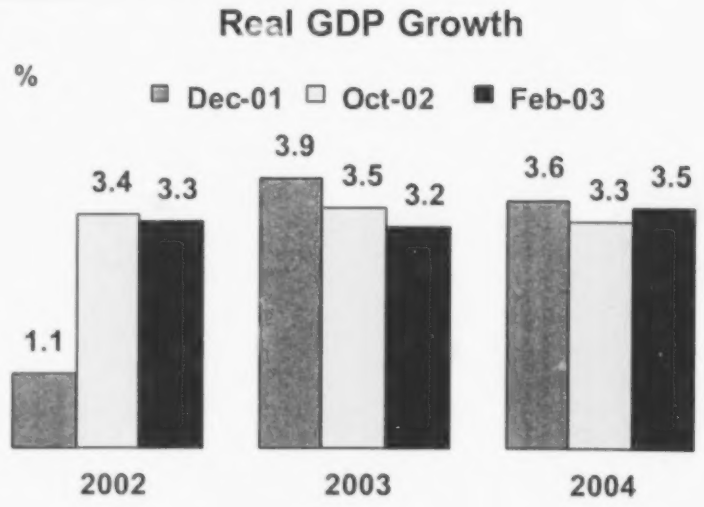
Annex

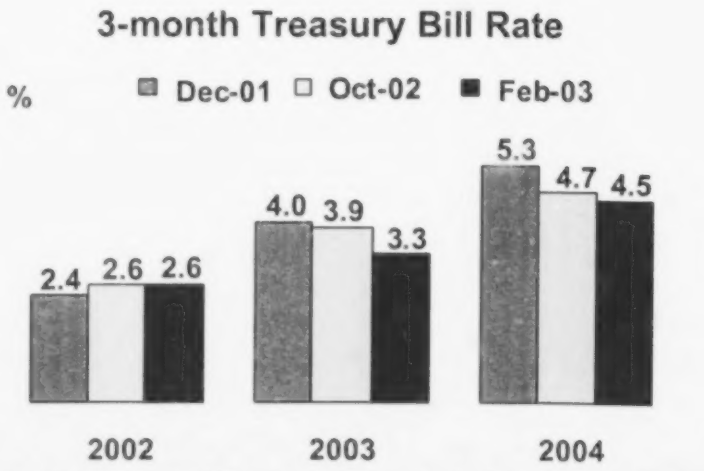
Budget 2003: Highlights

Canada

The Economic Outlook

- The economic outlook for the U.S. and Canada has been downgraded somewhat since the October fiscal update.
  - The U.S. economy is expected to gain momentum in the second half of this year, growing by 2.7% in 2003 and 3.6% in 2004.
  - The Canadian economy is estimated to have grown by 3.3% in 2002 and to grow by 3.2% this year, helped by low interest rates.
- However, the geopolitical uncertainty poses significant downside risks to the global economic outlook, particularly in the short-run.



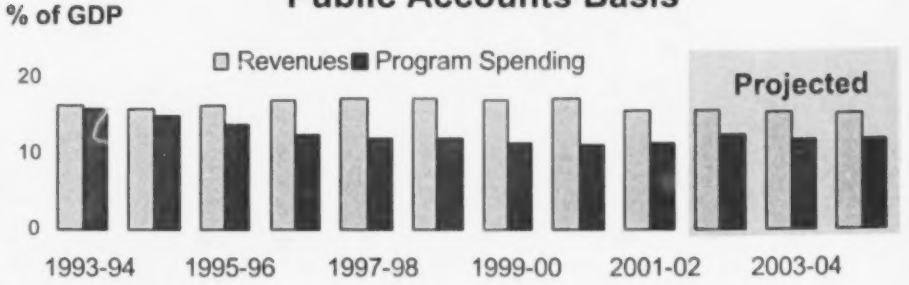


Source: Department of Finance surveys of private sector forecasters

Fiscal Projections

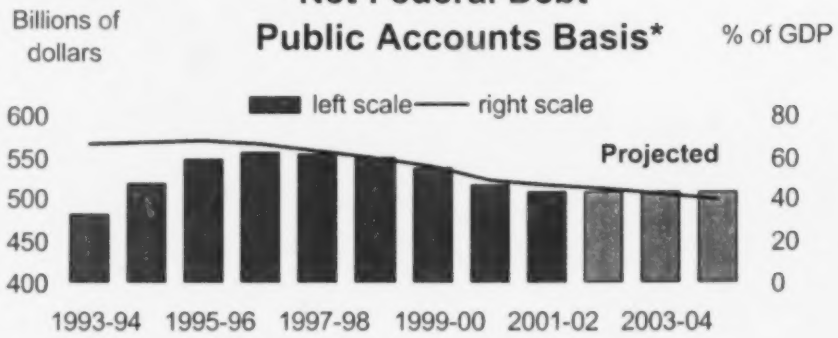
- A balanced budget or better is foreseen for 2002-03 and the following two years.
- Planning budgetary surpluses (after the Contingency Reserve and the economic prudence) are up from the Economic and Fiscal Update of last October: $6.4 billion in 2002-03, $4.8 billion in 2003-04 and $6.5 billion in 2004-05.
- Revenues are projected to rise to $178.7 billion (or 15.7% of GDP) in 2002-03 and to $184.7 billion (or 15.4% of GDP) in 2003-04.
- Program spending is expected to rise by 11.5% to $138.6 billion in 2002-03 (or 12.2% of GDP) and to $143 billion (or 11.9% of GDP) in 2003-04.
- The debt-to-GDP ratio is projected to fall to 44.5% in 2002-03, down from a peak of 67.5% in 1995-96.

Federal Revenues and Program Spending
Public Accounts Basis



Source: Department of Finance

Net Federal Debt
Public Accounts Basis*



Source: Department of Finance

Key Measures: Health

- Federal support to health care will increase by $17.3 billion over the next three years and by $34.8 billion over the next five years. The key elements are:

  - $2.5 billion in immediate investment through a CHST supplement.

  - $16.0 billion over five years to provinces and territories for a Health Care Reform Fund targeted to primary health care, home care and catastrophic drug coverage.

  - $9.5 billion in transfers to provinces and territories over the next five years.

  - $6.8 billion over five years to other health initiatives and support to First Nations and Inuit health programs.

Key Measures: Innovation and Knowledge

- The accumulative investments,1998-99 to 2004-05, in research and innovation from previous budgets is over $11 billion. The 2003 Budget announces a further investment of $1.7 billion in research and innovation in 2002-03 and over the next two years. Some key elements are:

  - Investments of $500 million in the Canada Foundation for Innovation, new Canada Graduate Scholarships and measures to expand venture capital and fund indirect costs of federally-sponsored research.

  - A permanent increase of $125M per year for the three federal granting councils.

  - $225M per year to universities, colleges, and research hospitals to address their indirect costs and $16M over the next two years to expand federal programs related to northern science.

- The budget provides $285 million in 2002-03 and the next two years for skills and learning, including measures to attract and facilitate the integration of skilled immigrants.

Key Measures: Using, Commercializing Knowledge

Encourage the commercialization of world-first innovations, partnerships and facilitating of technology transfer, especially for Small-medium enterprises (SMEs):

- $25M per year to IRAP's core programming to support SMEs;
- An investment of $190M over two years in the BDC, in the form of dividend-paying common shares, to augment venture capital for knowledge-based industries, export-oriented businesses and women entrepreneurs;
- $20M over two years to ABC to expand its activities for Aboriginal entrepreneurs;
- A federal contribution of $20M to the MaRS Discovery Center.

Key Measures: Taxation

- Previously-announced tax cuts to proceed
- Business Income Tax Measures
  - Federal capital tax to be phased-out over next five years - eliminated for medium-sized enterprises in 2004.
  - 21% corporate tax rate extended to resource sector - subject to restructuring of some tax preferences.
  - EI Premiums reduced from $2.10 to $1.98 for 2004.
  - Threshold for small business tax rate increased to $300,000.
  - Tax-free rollover of small business capital gains enhanced.
- Personal Income Tax Measures
  - Contribution limits for Registered Retirement Savings Plans and Registered Pension Plans to be increased to $18,000 over four years and indexed.
  - Child Tax Benefits enhanced - benefits increasing to $3,243 for the first child by 2007.
  - $1,600 Child Disability Tax Credit introduced effective July, 2003.

Key Measures: Communities and the Environment

- There will be $3 billion in spending over 10 years for infrastructure support including:
  - $526 million over the next two years for housing renovation programs and to homelessness.
  - $320 million over the next five years to enhance existing affordable housing agreements with provinces and territories.
- Environmental measures totaling $3 billion, of which:
  - $2 billion over five years to help implement the Climate Change Plan.
  - $600 million to upgrade water systems.

For Further Information

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